

DEPARTMENT OF STATE REVENUE
FIRST SUPPLEMENTAL LETTER OF FINDINGS NUMBER 04-960205
SALES AND USE TAX

For Tax Periods: 1990 Through 1993

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ISSUES

1. Sales and Use Tax: Dead Stock

Authority: IC 6-2.5-3-1, IC 6.2-5-3-2.

Taxpayer protests the assessment of tax on dead stock.

2. Sales and Use Tax: License Agreement

Authority: IC 6-2.5-4-10, Information Bulletin #8.

Taxpayer protests the assessment of tax on a license agreement.

3. Sales and Use Tax: Paint Thinner

Authority: IC 6-2.5-5-5.1, 45 IAC 2.2-5-12 (c).

Taxpayer protests the assessment of tax on paint thinner.

4. Sales and Use Tax: Safety Equipment

Authority: 45 IAC 2.2-5-8(c)(2)(F). 45 IAC 2/2-5-8(c)(4)(B).

Taxpayer protests the assessment of tax on safety equipment.

5. Sales and Use Tax: Waste Water Treatment

Authority: IC 6-2.5-5-3(b).

Taxpayer protests the assessment of tax on certain items in the waste water treatment facility.

6. Sales and Use Tax: Book Entries

Authority: IC 6-8.1-5-1.

Taxpayer protests the assessment of tax on book entries.

7. Sales and Use Tax: Lump Sum Contracts

Authority: IC 6-2.5-4-9.

Taxpayer protests the assessment of tax on lump sum contracts.

Statement of Facts

Taxpayer is a manufacturer which was incorporated in Indiana. Taxpayer's production is scheduled in at least two week intervals. The production intervals enable suppliers to have materials at Taxpayer's facility in a timely manner with minimum inventory. Taxpayer protested the audit assessment. A hearing was held and Letter of Findings issued. Taxpayer requested a rehearing on several issues addressed in the Letter of Findings. Further facts will be provided as necessary.

1. Sales and Use Tax: Dead Stock

Discussion

Taxpayer protested the assessment of use tax on amounts in the "dead stock" account. "Dead stock" is the name of a general ledger account that tracks amounts paid to suppliers for parts not needed by Taxpayer due to changes in Taxpayer's production schedule. Taxpayer compensates suppliers for any reasonable costs incurred due to a change in Taxpayer's production schedule. Pursuant to their contracts, Taxpayer's suppliers are not allowed to resell the parts to other parties unless they are generic parts. Taxpayer controls the final disposition of the parts for a price. IC 6-2.5-3-1 defines a taxable use in Indiana as the "exercise of any right or power of ownership over tangible personal property." Use tax was properly applied to the book entries representing

payments for Taxpayer's control of the disposition of the obsolete inventory pursuant to IC 6-2.5-3-2.

Finding

Taxpayer's first point of protest is denied.

2. Sales and Use Tax: License Agreement

Discussion

Taxpayer has dropped its protest to the tax assessed on one of the two licensing agreements and continues to protest the assessment on the licensing agreement with Vendor A.

Pursuant to IC 6-2.5-4-10 gross retail tax applies to the leasing of tangible personal property. Indiana Department of Revenue Information Bulletin # 8 defines canned software as tangible personal property and custom designed software as intangible personal property exempt from the gross retail tax. Taxpayer submitted a letter from Vendor A explaining in great detail that in this particular instance the software leased to Taxpayer is in actuality custom designed for this Taxpayer. Therefore, this lease agreement is exempt from the gross retail tax.

Finding

Taxpayer's protest to the tax assessed on the license agreement is sustained.

3. Sales and Use Tax: Paint Thinner

Discussion

Taxpayer has automatic painting machines which are computer operated in its paint shop. They are programmed to automatically spray paint Taxpayer's products as they move in the production process. The painting robots move their arms specifically to spray different models of Taxpayer's products. These robots are also programmed to change color. Each time the color is changed, paint thinner will circulate at the tip of the painting robots to remove existing paint so that the new paint color can be sprayed without blotting the vehicles or contaminating the new paint.

Taxpayer contends that this paint thinner is exempt from tax pursuant to IC 6-2.5-5-5.1 because it is consumed in the manufacturing process. The Regulations further explain this exemption at 45 IAC 2.2-5-12 (c) as follows:

The state gross retail tax does not apply to purchases of materials to be directly consumed in the production cycle or in mining, provided such materials have an immediate effect upon the article being produced or mined. In determining whether the property is directly consumed, consideration must be given to the change effected by the property in question upon the product being produced.

The paint thinner used by Taxpayer is not mixed with the paint that is applied to Taxpayer's product or become a part of the finished product. Rather, the paint thinner cleans the paint applicator between production jobs. The consumption of cleaning supplies is not a part of production. Therefore the paint thinner is subject to the gross retail tax.

Finding

Taxpayer's protest to the assessment of tax on the paint thinner is denied.

4. Sales and Use Tax: Safety Equipment

Discussion

The audit assessed additional tax on a safety fence, guardrails, safety gloves, safety sleeves and safety aprons. Taxpayer contends that the items qualify for exemption because they are required by OSHA safety regulations. 45 IAC 2.2-5-8(c)(2)(F) states that equipment required to allow workers to participate in the production process without injury is exempt from Tax. However, equipment primarily for the workers' comfort and convenience is taxable. 45 IAC 2.2-5-8(c)(4)(B). The safety fence, safety gloves, safety sleeves and safety aprons protested in this section were actually used to protect the workers from injury in the workplace and has a direct link to the production. Therefore these items allow the workers to participate in the production process and they qualify for exemption. The guardrails play no role in the integrated process from an operational standpoint and do not qualify for exemption.

Finding

The protest to the assessment of tax on the guardrails is denied. The protests to the assessment of tax on the other safety items is sustained.

5. Sales and Use Tax: Waste Water Treatment

Discussion

Taxpayer protested the assessment of tax on chemicals and equipment such as beakers which were used in the wastewater treatment facility. These items were used in an EPA mandated wastewater purification system. As such, the items qualify for exemption from the gross retail tax.

Finding

This point of Taxpayer's protest is sustained.

6. Sales and Use Tax: Book Entries

Discussion

Taxpayer contends that in several instances the Auditor used the incorrect conversion tables to convert Japanese Yen to United States Dollars. Taxpayer bears the burden of proving that the conversion tables were incorrect. IC 6-8.1-5-1. Taxpayer did not sustain this burden of proof.

Finding

This point of Taxpayer's protest is denied.

7. Sales and Use Tax: Lump Sum Contracts

Discussion

Pursuant to IC 6-2.5-4-9 gross retail tax applies to lump sum contracts unless the purchaser would be exempt from the tax. Taxpayer entered into several lump sum contracts for improvements to their real estate and installation of machinery. Taxpayer issued exemption certificates although they did not qualify for exemption. Taxpayer requested an opportunity to submit evidence that the contractors had actually paid the sales tax on the materials used in fulfilling the contracts. Taxpayer did not produce such evidence.

Finding

Taxpayer's protest is denied.